Canadian Dairy Commission | Commission canadienne du lait

Quarterly Financial Report

Second quarter

November 2016 to January 2017

Contents

Quarterly Financial Report

Second quarter (Q2) – November 2016 to January 2017

Management Discussion and Analysis

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the quarter ending January 2017 should be read in conjunction with the financial statements enclosed herein and the 2015-2016 Annual Report.

1. Basis of Preparation

This discussion was prepared in accordance with the Treasury Board Standard on Quarterly Financial Reports for Crown Corporations (Treasury Board Standard). This narrative discussion is not intended to be a full Management Discussion and Analysis (MD&A). Disclosures and information in the Canadian Dairy Commission's July 31, 2016 annual report are assumed to apply to the current quarter unless otherwise updated below.

The financial statements are unaudited and have been prepared in Canadian dollars in accordance with International Accounting Standard 34, *Interim Financial Reporting* (IAS 34) and the Treasury Board Standard. This narrative discussion and the accompanying financial statements were reviewed and approved by the CDC Board of directors.

2. Financial Results

Domestic Activities

	For the quarter ended January 31			For the six months ended January 31		
(in thousands)	2017	2016	$ change	2017	2016	$ change
Domestic sales revenue	$ 96,322	$ 62,927	$33,395	$ 181,669	$ 115,412	$ 66,257
Cost of goods sold - domestic	$ 86,933	$ 52,492	$34,441	$ 166,739	$ 99,629	$ 67,110
Transport and carrying charges	$ 1,686	$ 1,391	$ 295	$ 3,286	$ 2,747	$ 539
Finance costs	$ 47	$ 43	$ 4	$ 138	$ 103	$ 35
Gross profit on domestic sales	**$ 7,656**	**$ 9,001**	**$ (1,345)**	**$ 11,506**	**$ 12,933**	**$ (1,427)**

The CDC purchases and sells butter and skim milk powder (SMP) in order to regulate the supply of dairy products in the domestic market throughout the year.

Year-to-date (YTD) and Q2 domestic sales revenue increased compared to the same period last year. This was mainly due to higher sales of butter.

Year-to-date (YTD) and Q2 gross profit on domestic sales decreased compared to the same period last year. This was mainly due to lower returns on Class 4(m) SMP to animal feed manufacturers.

Export Activities

(in thousands)	For the quarter ended January 31 2017	2016	$ change	For the six months ended January 31 2017	2016	$ change
Export sales revenue	$ 9,090	$ 5,945	$ 3,145	$ 18,824	$ 13,610	$ 5,214
Cost of goods sold - exports	$ 7,248	$ 4,745	$ 2,503	$ 15,551	$ 11,461	$ 4,090
Transport and carrying charges	$ 680	$ 114	$ 566	$ 1,436	$ 277	$ 1,159
Finance costs	$ 6	$ 1	$ 5	$ 10	$ 2	$ 8
Gross profit on export sales	**$ 1,156**	**$ 1,085**	**$ 71**	**$ 1,827**	**$ 1,870**	**$ (43)**

The YTD and Q2 export sales activities were similar to the previous year. The CDC purchases surplus dairy products destined for export at prices that take into account prevailing world market conditions, with the intent of breaking even over the course of a dairy year. As these markets are difficult to predict, this activity may generate losses or gains in the course of a year, with the objective of breaking even at year's end.

Other Revenues

(in thousands)	For the quarter ended January 31 2017	2016	$ change	For the six months ended January 31 2017	2016	$ change
Funding from milk pools	$ 1,597	$ 1,510	$ 87	$ 3,141	$ 2,989	$ 152
Funding from the Government of Canada	$ 1,004	$ 974	$ 30	$ 1,921	$ 1,848	$ 73
Audit services	$ -	$ 19	$ (19)	$ -	$ 49	$ (49)
Total Other Revenues	**$ 2,601**	**$ 2,503**	**$ 98**	**$ 5,062**	**$ 4,886**	**$ 176**

The funding from milk pools represents the revenues obtained from producers and the marketplace to finance a portion of the CDC's administrative expenses, the cost of production study, as well as the carrying charges associated with the CDC butter stocks. The YTD and Q2 results for 2016-2017 are higher compared to the previous year's mainly due to an increase in industrial milk production which impacts the amount the CDC collects from the marketplace through the milk pools.

Parliamentary appropriations for operating expenditures are recognized in the Statement of Operations and Comprehensive Income based on government-funded administrative expenses. This year's funding from the Government of Canada was slightly higher than the previous year.

Revenues obtained for audit services relate to the milk utilization audits performed in plants by the CDC in 6 provinces on a cost-recovery basis. Revenues from audit services are recognized when the service is rendered.

Operating and Administrative Expenses

Operating Expenses

(in thousands)	For the quarter ended January 31 2017	2016	$ change	For the six months ended January 31 2017	2016	$ change
Operating expenses						
Industry initiatives	$ 76	$ 66	$ 10	$ 190	$ 93	$ 97
Cost of Production study	$ 184	$ 181	$ 3	$ 382	$ 378	$ 4
Other charges (recoveries)	$ 532	$ 2	$ 530	$ 2	$ 309	$ (307)
Total operating expenses	**$ 792**	**$ 249**	**$ 543**	**$ 574**	**$ 780**	**$ (206)**
Administrative expenses						
Salaries and employee benefits	$ 1,542	$ 1,498	$ 44	$ 3,034	$ 2,934	$ 100
Other administrative expenses	$ 459	$ 538	$ (79)	$ 826	$ 912	$ (86)
Total administrative expenses	**$ 2,001**	**$ 2,036**	**$ (35)**	**$ 3,860**	**$ 3,846**	**$ 14**
Total operating and administrative expenses	**$ 2,793**	**$ 2,285**	**$ 508**	**$ 4,434**	**$ 4,626**	**$ (192)**

YTD expenses relating to “industry initiatives” increased by $0.97 million for the second quarter ending January 31, 2017 compared to the same period of the previous year. This slight increase is attributable to the timing of expenses mainly relating to the market development initiative.

“Other charges” include amounts representing unrealized gains or losses on outstanding foreign exchange contracts as of the Statement of Financial Position date. These gains or losses are determined using the difference between the contracted rates and exchange rates as of the Statement of Financial Position date, applied to the contract amount. They vary with the fluctuations of exchange rates as well as with the value of outstanding foreign exchange contracts at the end of the period.

Administrative Expenses

Total administrative expenses for the YTD ending January 31, 2017 were $3.86 million which is basically in line with the previous year’s results.

Inventories and Loans

Inventory value as of January 31, 2017 was $102.77 million compared to $62.71 million as of January 31, 2016, which represents an important increase.

CDC butter stocks at the end January 2017 were approximately 2,721 t, an increase of 1,693 t compared to the same period last year. Butter inventory levels at this time last year were below normal. As a result of the measures that were undertaken to stimulate milk production, stocks have increased in order to meet the continued growth in demand for butter and butterfat.

Skim milk powder stocks (SMP) increased by 9,835 t compared the same period last year. The growth in demand for butterfat resulted in an increase of surplus of solids non fat (SNF) that the CDC had to purchase in the form of SMP this past 12 months.

The loan from the Government at the end of January 2017 was $32.73 million compared to $29.01 million at the same time last year. Although we had higher inventories and payments made to suppliers during the last six months compared with the same period last year, this was partly offset by an increase in retained earnings which resulted in only a slight increase in loan requirements.

Cash Flows

	For the quarter ended January 31		For the six months ended January 31	
(in thousands)	2017	2016	2017	2016
Cash flows from (used in) operating activities	$ 17,570	$ 25,937	$ 69,107	$ 7,420
Cash flows (used in) from financing activities	$ (12,158)	$ (25,740)	$ (61,460)	$ (6,405)
Net increase in net cash (bank overdraft)	**$ 5,412**	**$ 197**	**$ 7,647**	**$ 1,015**
Net bank overdraft at beginning of period	$ (1,748)	$ (2,371)	$ (3,983)	$ (3,189)
Net cash (bank overdraft) at end of period	**$ 3,664**	**$ (2,174)**	**$ 3,664**	**$ (2,174)**

The CDC's closing bank cash position for the end of the Q2 2016-2017 was $3.66 million compared to an overdraft of $2.17 million for the same period in the previous year. This represents a year-over-year increase in net cash position of $5.84 million.

Cash flows from operating activities

For YTD ending January 31, 2017, net cash inflows from operating activities were $69.11 million compared to net cash inflows of $7.42 million for the same period ending January 31, 2016. The change was a result of higher domestic sales during the last six months compared with the same period last year.

Cash flows from financing activities

For YTD ending January 31, 2017, net cash outflows from financing activities were $61.46 million for Q2 2016-2017 compared to net outflows of $6.41 million for Q2 2015-2016. CDC's financing is directly related to its selling and purchasing activities as the loan from the Government of Canada fluctuates daily depending on the cash position at the end of the day. This increase was due to higher cash receipts from customers as well as lower payments made to suppliers for YTD ending January 31, 2017.

3. Outlook against the Corporate Plan Summary

Key factors that may impact the budget reported in the CDC's Corporate Plan Summary are total industrial milk production, domestic requirements, support prices, and world market conditions for the sale of dairy products. Any significant changes in these key assumptions will affect the budgeted results.

Total milk production has continued to increase to meet market growth. As of January 31, 2017, production for the most recent 12 months has continued to grow and, coupled with supplementary butter imports, was enough to satisfy domestic milk requirements. As expected, CDC butter stocks held in Plan B decreased over the past few months and started building again in January 2017. Private stocks of butter have increased steadily since October 2016 to reach 17 thousand tonnes in January 2017 which is in line with the same period a year ago. The further processing sector continued to experience difficulties in sourcing butter from Canadian butter makers due to limited supplies. To relieve the pressure of this sector, the CDC kept importing butter for that market.

In the Corporate Plan Summary, the forecast for total milk production was 342 M kg of butterfat. Total milk production is now expected to reach 361 M kg of butterfat by the end of the dairy year, which is 5.5% higher than the CDC's original forecast. Total requirements were also expected to reach 342 M kg of butterfat and they are currently forecasted to end the dairy year at 363 M kg of butterfat, which is 6.1% higher than the CDC's original forecast.

World market prices for skim milk powder are showing signs of weakness again after several months of recovery. So far, the CDC has concluded sales for approximately 90% of Canada's subsidized SMP export entitlement under the World Trade Organization (WTO) Agreement on Agriculture.

4. Appropriations

The following table reconciles the appropriations received and disbursed.

	For the quarter ended January 31			For the six months ended January 31		
(in thousands)	2017	2016	$ change	2017	2016	$ change
Opening Balance	$ -	$ -	$ -	$ -	$ -	$ -
Parliamentary appropriations	$ 1,004	$ 974	$ 30	$ 1,921	$ 1,848	$ 73
Amount disbursed	$ (1,004)	$ (974)	$ (30)	$ (1,921)	$ (1,848)	$ (73)
Ending Balance	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

These appropriations were granted via the Main Estimates. Parliamentary appropriations are used to fund part of the CDC's administrative expenses. The remainder of the CDC's administrative expenses are funded by dairy producers, commercial operations, and the marketplace.

Government of Canada funding for administrative expenses is appropriated to the CDC based on the Government fiscal year (April to March) while the use of these funds is presented in these statements on a dairy year (August to July) basis. The CDC does present the use of its appropriations on a Government fiscal year basis in the Public Accounts of Canada.

5. Risk Management

There have been no significant changes in the risk that the CDC faces since the publication of the CDC's 2015-2016 Annual Report.

6. Significant Changes

The following significant changes in operations, personnel, objectives, industry initiatives and programs have occurred between August 1, 2016 and January 31, 2017, compared to the Corporate Plan Summary.

Operations, industry initiatives and programs	To supply the further processing sector in butter, the CDC obtained a supplementary import permit equivalent to 12,000 tonnes of butter. The CDC has been selling on average 1,900 t of butter per month since August 1.
Personnel	Following the departure of the COO, the CDC adopted a new structure. CDC divisions are now Audit and Evaluation, Commercial Operations and Marketing, Corporate Services, Finance and Administration, and Policy and Economics.
Objectives	There has been no significant change in objectives compared to the Corporate Plan Summary.
Governing Board	The mandate of our commissioner, Mr. Hennie Bos, ended on October 1, 2016. On January 3, Ms. Jennifer Hayes was appointed as commissioner of the CDC for a three-year mandate.

Management Responsibility for Financial Statements

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the requirements of International Accounting Standard 34: *Interim Financial Reporting* (IAS 34), and for such internal controls as management determines are necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements. These statements are unaudited and have not been reviewed by an external auditor.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of, and for the periods presented in the quarterly financial statements.

Original signed by

Jacques Laforge, Chief Executive Officer

Chantal Laframboise, Director, Finance and Administration

Ottawa, Canada

March 21, 2017

Canadian Dairy Commission
Statement of Financial Position

(unaudited)
(in thousands of Canadian dollars)

	As at January 31, 2017	As at July 31, 2016
Assets		
Current		
Cash	$ 4,262	$ 47
Trade and other receivables		
Trade receivables	6,876	2,202
Advance to provincial milk boards and agencies	598	4,030
Milk pools	1,143	1,083
Derivative asset - foreign exchange contracts	2	2
Inventory (Note 4)	102,768	137,345
	115,649	144,709
Non-Current		
Equipment	24	26
Intangible asset	211	225
	$ 115,884	$ 144,960
Liabilities		
Current		
Bank overdraft (Note 5)	$ 598	$ 4,030
Trade and other payables		
Trade payables	32,303	9,182
Distribution to provincial milk boards and agencies	-	5,944
Other liabilities	5,630	946
Derivative liability - foreign exchange contracts	-	9
Loans from the Government of Canada (Note 6)	32,732	94,192
	71,263	114,303
Non-Current		
Post-employment benefits	72	69
Equity		
Retained earnings	44,549	30,588
	$ 115,884	$ 144,960

Commitments (Note 12)

The accompanying notes are an integral part of these financial statements.

These financial statements were approved and authorized for issue on March 21, 2017.

Jacques Laforge	Alistair Johnston	Chantal Laframboise
Chief Executive Officer	Chairman	Director, Finance and Administration

Canadian Dairy Commission

Statement of Operations and Comprehensive Income

(unaudited)

(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2017	January 31, 2016	January 31, 2017	January 31, 2016
Sales and cost of sales				
Domestic sales revenue	$ 96,322	$ 62,927	$ 181,669	$ 115,412
Cost of goods sold - domestic	86,933	52,492	166,739	99,629
Transport and carrying charges	1,686	1,391	3,286	2,747
Finance costs	47	43	138	103
Gross profit on domestic sales	7,656	9,001	11,506	12,933
Export sales revenue	9,090	5,945	18,824	13,610
Cost of goods sold - exports	7,248	4,745	15,551	11,461
Transport and carrying charges	680	114	1,436	277
Finance costs	6	1	10	2
Gross profit on export sales	1,156	1,085	1,827	1,870
Total gross profit	8,812	10,086	13,333	14,803
Other income				
Funding from milk pools	1,597	1,510	3,141	2,989
Funding from the Government of Canada (Note 9)	1,004	974	1,921	1,848
Audit services	-	19	-	49
	2,601	2,503	5,062	4,886
Total gross profit and other income	**11,413**	**12,589**	**18,395**	**19,689**
Operating expenses				
Industry initiatives	76	66	190	93
Cost of Production study	184	181	382	378
Other charges (recoveries)	532	2	2	309
	792	249	574	780
Administrative expenses				
Salaries and employee benefits (Note 10)	1,542	1,498	3,034	2,934
Other administrative expenses	459	538	826	912
	2,001	2,036	3,860	3,846
Total operating and administrative expenses	**2,793**	**2,285**	**4,434**	**4,626**
Profit before distribution to provincial milk boards and agencies	**8,620**	**10,304**	**13,961**	**15,063**
Distribution to provincial milk boards and agencies	-	-	-	-
Total comprehensive income	**$ 8,620**	**$ 10,304**	**$ 13,961**	**$ 15,063**

The accompanying notes are an integral part of these financial statements.

Canadian Dairy Commission
Statement of Changes in Equity

(unaudited)
(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2017	January 31, 2016	January 31, 2017	January 31, 2016
Retained earnings, beginning of the period	$ 35,929	$ 16,840	$ 30,588	$ 12,081
Total comprehensive income for the period	8,620	10,304	13,961	15,063
Retained earnings, end of the period	$ 44,549	$ 27,144	$ 44,549	$ 27,144

The accompanying notes are an integral part of these financial statements.

Canadian Dairy Commission
Statement of Cash Flows

(unaudited)

(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2017	January 31, 2016	January 31, 2017	January 31, 2016
Cash flows from (used in) operating activities				
Cash receipts from sales of goods	$ 100,663	$ 68,541	$ 195,851	$ 127,089
Cash paid to suppliers and others	(80,742)	(45,399)	(128,992)	(105,022)
Cash receipts from provincial milk boards and agencies (pooling)	2,691	1,880	6,513	3,807
Cash paid to provincial milk boards and agencies	(5,944)	-	(5,944)	(20,190)
Cash receipts from the Government of Canada	1,004	974	1,921	1,848
Interest paid on loans	(102)	(59)	(242)	(112)
Net cash flows from (used in) operating activities	**17,570**	**25,937**	**69,107**	**7,420**
Cash flows (used in) from financing activities				
New loans from the Government of Canada	55,220	21,561	73,429	77,249
Loan repayments to the Government of Canada	(67,378)	(47,301)	(134,889)	(83,654)
Net cash flows (used in) from financing activities	**(12,158)**	**(25,740)**	**(61,460)**	**(6,405)**
Net increase in net cash (bank overdraft)	5,412	197	7,647	1,015
Net bank overdraft at beginning of period	(1,748)	(2,371)	(3,983)	(3,189)
Net cash (bank overdraft) at end of period	**$ 3,664**	**$ (2,174)**	**$ 3,664**	**$ (2,174)**
Components:				
Cash	$ 4,262	$ 201	$ 4,262	$ 201
Bank overdraft	(598)	(2,375)	(598)	(2,375)
Net cash (bank overdraft)	**$ 3,664**	**$ (2,174)**	**$ 3,664**	**$ (2,174)**

The accompanying notes are an integral part of these financial statements.

Notes to Unaudited Financial Statements – January 31, 2017

1. Authority and objectives

The Canadian Dairy Commission (CDC) was established in 1966 through the Canadian Dairy Commission Act. It is a federal Crown corporation named in Part I, Schedule III and Schedule IV to the Financial Administration Act and is not subject to the provisions of the Income Tax Act. It is an agent of Her Majesty the Queen in right of Canada and reports to Parliament through the Minister of Agriculture and Agri-Food.

The objectives of the CDC are to provide efficient producers of milk with the opportunity to obtain a fair return for their labour and investment and to provide consumers with a continuous and adequate supply of dairy products. To achieve its objectives, the CDC works closely with the Canadian Milk Supply Management Committee (CMSMC), which it chairs, as well as with provincial governments and provincial milk marketing boards. This collaboration is framed by federal-provincial agreements.

The CDC is partly funded by parliamentary appropriations. This is supplemented by funding from milk producers and the market, as well as by the CDC's own commercial operations.

Directive on Travel, Hospitality, Conference and Event Expenditures
In July 2015, the CDC was issued a directive (P.C. 2015-1104) pursuant to section 89 of the *Financial Administration Act* to align its travel, hospitality, conference and event expenditure policies, guidelines and practices with Treasury Board policies, directives and related instruments in a manner that is consistent with its legal obligations. The CDC continues to meet the requirements of this directive.

2. Basis of preparation

Statement of compliance

The CDC prepared these financial statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations and IAS 34 – *Interim Financial Reporting*, using International Financial Reporting Standards (IFRS).

The financial statements were approved and authorized for issue by the CDC board on March 21, 2017.

Basis of presentation

The financial statements have been prepared on a historical cost basis, as set out in the accounting policies below, except as permitted by IFRS and otherwise indicated within these notes.

Reporting period

The CDC reports on a dairy year basis which starts August 1 and ends July 31.

The reporting period for these interim financial statements and notes thereto is August 1, 2016 to January 31, 2017. This represents the second quarter (Q2 2016-2017) of operations for the CDC's dairy year ending July 31, 2017.

Use of judgement, estimates and assumptions

The preparation of financial statements in accordance with IFRS requires management to exercise judgment and make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the year. Areas where management has exercised judgment and made significant use of estimates and assumptions are discussed below.

Plan B Inventory

Under section 9(1) of the Canadian Dairy Commission Act, the CDC operates Domestic Seasonality Programs, which include the purchase and sale of Plan B inventory (butter and skim milk powder). Under Plan B, as set out in agreements with manufacturers, the CDC purchases products from manufacturers and manufacturers are contractually obligated to repurchase Plan B inventory within the course of the next dairy year at the prevailing support prices.

Although the CDC has customarily honoured all manufacturers' requests for repurchase, the CDC has determined that the significant risks and rewards of ownership have been transferred to the CDC on the purchase of this inventory since the CDC is not contractually bound to sell to the manufacturers and because the CDC bears all costs of holding the inventory as well as the risks of theft or damage.

Allowance for inventory write-down

Management determines the allowance for inventory write-down through the use of assumptions. The net realizable value of inventory on hand at year end is estimated using the price of milk on the international market as well as the price of existing contracts at or around year-end. These estimates are reviewed annually and as adjustments become necessary, they are recognized in the Statement of Operations and Comprehensive Income of the period in which they become known.

Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the functional and presentation currency of the CDC.

3. Significant accounting policies

Cash

Cash includes funds on deposit at financial institutions.

Financial instruments

Financial assets and financial liabilities are initially recognized at fair value. Their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics, and the CDC's designation of such instruments.

Classifications:

Trade and other receivables…..………….	Loans and receivables
Bank overdraft……………….……………...	Financial liabilities measured at amortized cost
Trade and other payables……..................	Financial liabilities measured at amortized cost
Loans from the Government of Canada …	Financial liabilities measured at amortized cost
Derivative assets and liabilities…………….	Financial assets or liabilities measured at fair value through profit or loss (FVTPL)

Loans and receivables

Loans and receivables are recorded at amortized cost using the effective interest method.

Financial liabilities measured at amortized cost

Financial liabilities measured at amortized cost are measured using the effective interest method.

Financial assets or liabilities measured at FVTPL

Financial assets or liabilities classified as FVTPL are measured at fair value at the Statement of Financial Position date with changes in fair value recorded in profit or loss on the Statement of Operations and Comprehensive Income.

Transaction costs

All transaction costs in respect of financial instruments classified as loans and receivables or financial liabilities measured at amortized cost are capitalized in the period in which they are incurred. All transaction costs in respect of financial instruments classified as financial assets or liabilities measured at FVTPL are expensed in the period in which they are incurred.

Derivative financial instruments

The CDC uses derivative financial instruments such as forward contracts to counter the adverse movements in foreign exchange related to purchases and sales denominated in foreign currencies, including anticipated transactions, as well as to manage its cash balances and requirements. The CDC's policy is not to utilize freestanding derivative financial instruments for trading or speculative purposes.

The CDC does not designate its foreign exchange forward contracts as hedges of underlying assets, liabilities, firm commitments or anticipated transactions and accordingly does not apply hedge accounting. As a result, foreign exchange forward contracts are recorded on the Statement of Financial Position at fair value as an asset when the contracts are in a gain position and as a liability when the contracts are in a loss position. Changes in fair value of these contracts are recognized as gains or losses within "Other charges (recoveries)" on the Statement of Operations and Comprehensive Income.

Inventory

Inventory is recorded at the lower of cost, which is purchase cost, or estimated net realizable value. Cost is determined on a first-in, first-out basis except for Plan B inventories where cost is determined based on specific identification. Write-downs to net realizable value are reversed when there is a subsequent increase in the value of inventory up to a maximum of the purchase cost. The reversal is recognized as a reduction to cost of sales and an increase to the net value of inventory in the year in which it occurs.

Equipment

Equipment is recorded at cost less accumulated depreciation. Cost includes all measurable expenditures directly attributable to the acquisition and installation of the equipment.

Depreciation is charged to "Other charges (recoveries)" on the Statement of Operations and Comprehensive Income and begins when the equipment is available for use by the CDC. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset less estimated residual value as follows:

Generator ………………………….10 years
Computer equipment……………….. 3-5 years

Equipment is reviewed annually for indications of impairment or changes in estimated future economic benefits. If such impairments or changes exist, the carrying value would be adjusted accordingly.

Intangible asset

Software

Internally developed application software is stated at cost less accumulated amortization. Cost includes all measurable expenditures directly attributable to the development of the software including employees' salaries, consultant fees and other identifiable costs specific to the project.

Amortization of the intangible asset is charged to "Other charges (recoveries)" on the Statement of Operations and Comprehensive Income on a straight-line basis over its estimated useful life of ten years.

Software is reviewed annually for indications of impairment or changes in estimated future economic benefits. If such impairments or changes exist, the carrying value would be adjusted accordingly.

Distributions to provincial milk boards and agencies

Distributions to provincial milk boards and agencies represent gross profit (loss) on sales excluding imported butter. Distributions to provincial boards and agencies are recorded as expense in the year that they are determined.

Revenues

Sales revenues

Domestic and export sales revenues are recognized when product is shipped.

Funding from milk pools

As acting agent in carrying out administrative functions of the Comprehensive Agreement on Pooling of Milk Revenues (a federal-provincial agreement), the CDC collects and redistributes producer market returns. For these services, the CDC receives from producers an annual fixed fee which offsets its cost for the administration of the agreement as well as the estimated carrying charges for normal levels of butter inventory. Furthermore, the CDC is reimbursed for other direct costs as set out in the agreement including carrying charges for surplus butter inventories.

Funding is recognized as revenue in the period as services are rendered and are accrued on a monthly basis over the fiscal year.

Funding from the Government of Canada

Funding from the Government of Canada is recognized as revenue in the period the expenses are incurred.

Audit services

Revenues from audit services are recognized in the period the services are rendered.

Cost of sales

The CDC purchases all butter and skim milk powder tendered to it at either the Canadian support price or at other prices established by the CDC, depending on the intended resale markets, except for a portion of butter imported by the CDC at international market prices. These costs are charged to cost of sales when the goods are shipped to customers.

Foreign currency translation

All foreign currency transactions are translated into Canadian dollars at the exchange rate in effect on the transaction date.

Trade receivables and payables in foreign currencies are adjusted to reflect the exchange rate in effect at the Statement of Financial Position date. Any corresponding gains or losses are recognized in “Export sales revenue” for receivables and “Cost of goods sold – domestic” for payables on the Statement of Operations and Comprehensive Income.

Most sales and purchases in foreign currencies have corresponding foreign exchange forward contracts (see "Derivative financial instruments" above and Note 11: *Financial Instruments – Currency risk*).

Employee benefits

Pension benefits

Substantially all of the employees of the CDC are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC to cover current service cost. Pursuant to legislation currently in place, the CDC has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service and represent the total pension obligation of the CDC.

Post-employment benefits

Eligible employees are entitled to post-employment benefits as provided for under labour contracts and conditions of employment. The cost of these benefits is accrued as employees render the services necessary to earn them. The obligation relating to the benefits earned by employees is calculated by management.

Application of new and revised accounting standards

The following amendment has been issued by the International Accounting Standards Board (IASB) effective for accounting periods that began on August 1, 2016 and affected amounts reported or disclosed in the financial statements:

> Disclosure Initiative – Amendments to IAS 1 – *Presentation of Financial Statements* was issued to provide additional guidance to help entities apply judgment when meeting the presentation and disclosure requirements in IFRS. The amendments clarify that materiality applies to the whole financial statements and that the inclusion of immaterial information can inhibit the usefulness of financial disclosures. The amendments clarify that entities should use professional judgment in determining where and in what order information is presented in the financial statements. The amendments are effective for annual periods beginning on or after January 1, 2016. These notes have been streamlined to reflect these amendments.

Future accounting standards (accounting standards issued but not yet applied)

A number of new accounting standards and amendments effective on or after August 1, 2017 have been issued by the IASB. As of the date of the financial statements, the following applicable standards and amendments have been assessed as having a possible impact on the CDC:

Disclosure Initiative – Amendments to IAS 7 – *Statement of Cash Flows* clarifies the disclosures required for changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. The CDC is currently assessing these amendments and therefore the extent of the impact of the adoption of the amendments is unknown.

IFRS 15 – *Revenue from Contracts with Customers* was issued to provide guidance on the recognition of contract revenues. This new standard will be effective for annual periods beginning on or after January 1, 2018. The CDC is currently assessing this new standard and therefore the extent of the impact of the adoption of the standard is unknown.

IFRS 9 – *Financial Instruments* The final version of this new standard was issued in July 2014. This standard largely retains the classification and measurement requirements and new hedge accounting model included in earlier versions, while introducing a single forward-looking expected credit loss impairment model. The new standard is effective for annual periods beginning on or after January 1, 2018. The CDC is currently assessing this new standard and therefore the extent of the impact of the adoption of the standard is unknown.

IFRS 16 – *Leases* provides a single lessee accounting model, requiring assets and liabilities to be recognized for all leases, unless the lease term is 12 months or less or the underlying asset has a low value. The new standard is effective for annual periods beginning on or after January 1, 2019. The CDC is currently assessing this new standard therefore, the extent of the impact of the adoption of the standard is unknown.

4. Inventory

The CDC's inventory is comprised of butter and skim milk powder purchased under the Domestic Seasonality and Surplus Removal Programs. The CDC also imports butter under the World Trade Organization (WTO) Agreement on Agriculture.

(In thousands of Canadian dollars, unless otherwise indicated)

Inventory:

	January 31, 2017		July 31, 2016	
	in $	in tonnes	in $	in tonnes
Plan B				
Butter	$ 19,310	2,412	$ 66,194	8,468
Skim milk powder	0	0	1,475	334
Other butter	1,916	309	2,328	432
Other skim milk powder	81,542	58,753	67,416	59,378
	102,768		137,413	
Less: allowance for inventory write-down	0		(68)	
Total net realizable value	$ 102,768		$ 137,345	

Inventory expensed in the second quarter was $94.18 million (Q2 2015-2016: $57.24 million) and is presented on the Statement of Operations and Comprehensive Income in “Cost of goods sold (domestic and exports)”.

Inventories of $28.11 million (July 31, 2016: $34.02 million) are expected to be recovered after more than 12 months.

5. Bank overdraft

The CDC has established a line of credit with a member of the Canadian Payments Association. The CDC has been granted the authority to establish this line of credit by the Minister of Finance up to a maximum of $50 million for advancing funds to the provincial milk marketing boards and agencies. On January 31, 2017 the available line of credit was $7 million (July 31, 2016: $5 million).

The bank overdraft incurred under the CDC’s line of credit is due on demand and bears interest at prime, which as at January 31, 2017 was 2.70% per annum (January 31, 2016: 2.70%).

6. Loans from the Government of Canada (Consolidated Revenue Fund)

Loans from the Government of Canada’s Consolidated Revenue Fund, to a maximum of $165 million (July 31, 2016: $165 million), are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest is repaid regularly during the year when funds are available.

Interest on the loans is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent at simple interest. Interest rates and interest expense were as follows:

(In thousands of Canadian dollars, unless otherwise indicated)

	Three months		Six months	
Interest rates	Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
Low	0.60%	0.50%	0.58%	0.50%
High	0.66%	0.62%	0.70%	0.79%
Interest expense	$ 53	$ 44	$ 148	$ 105

7. Capital management

The CDC's capital consists of its loans from the Government of Canada (see Note 6) and retained earnings. As of January 31, 2017 these accounts totaled $32.73 million (July 31, 2016: $94.19 million) and $44.00 million (July 31, 2016: $30.59 million) respectively. The CDC is not subject to any externally imposed capital requirements.

The CDC's primary objective in managing capital is to ensure that it has sufficient liquidity in order to settle its financial obligations as they become due and to fund programs for the benefit of the dairy industry. The CDC adjusts its capital management approach on an ongoing basis as the amounts fluctuate during the course of the year. The CDC does not utilize any quantitative measures to monitor its capital. There were no changes in the CDC's approach to capital management or the definition thereof as compared to the previous year.

8. Foreign exchange gains and losses

Export sales include amounts representing realized net gains or net losses arising from currency translation relating to transactions incurred in foreign currencies.

As well, domestic cost of sales include amounts representing realized net gains or net losses arising from currency translation relating to import purchase transactions incurred in foreign currencies.

	Three months		Six months	
Net gain (loss) on:	Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
Export sales	$ (97)	$ (145)	$ (147)	$ (348)
Domestic cost of sales	$ 1,163	$ 332	$ 1,575	$ 889

9. Funding from the Government of Canada

Funding of the CDC's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place.

Government of Canada funding of total administrative expenses is as follows:

(In thousands of Canadian dollars, unless otherwise indicated)

	Three months		Six months	
	Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
Funded by Government	$ 1,004	$ 974	$ 1,921	$ 1,848
Total administrative expenses	$ 2,001	$ 2,036	$ 3,860	$ 3,846

10. Salaries and employee benefits

Salaries and employee benefits includes:

	Three months		Six months	
	Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
Salaries expense	$1,284	$1,239	$2,554	$2,443
Pension contributions	163	170	302	321
Medical insurance expense	60	55	109	105
Others	35	34	69	65
Total	$1,542	$1,498	$3,034	$2,934

Pension plan

Substantially all of the employees of the CDC are covered by the public service pension plan (the “Plan”), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC. The President of the Treasury Board of Canada sets the required employer contributions based on a multiple of the employees’ required contribution. The general contribution rate effective for the quarter ended January 31, 2017 was on average 1.14 times the employee’s rate (1.28 times for the prior year).

The Government of Canada holds a statutory obligation for the payment of benefits relating to the Plan. Pension benefits generally accrue up to a maximum period of 35 years at an annual rate of 2% of pensionable service multiplied by the average of the best five consecutive years of earnings. The benefits are coordinated with Canada/Québec Pension Plan benefits and they are indexed to inflation.

(In thousands of Canadian dollars, unless otherwise indicated)

11. Financial instruments

In the course of carrying out its ongoing operations, the CDC faces risks to its financial assets and financial liabilities. The CDC's exposure to risk from its use of financial instruments is presented below along with the CDC's objectives, policies and processes for managing risk.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the CDC's income or the value of its holding of financial instruments.

Currency risk

The CDC operates internationally, exposing itself to market risks from changes in foreign exchange rates. The CDC partially manages these exposures by contracting only in US dollars or Canadian dollars. The CDC's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The CDC periodically enters into foreign exchange forward contracts to manage exposure to exchange rate fluctuations between Canadian and US dollars for future sales and purchases on existing contracts.

The fair value of the CDC's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the Statement of Financial Position date. This rate was 1.3012 at January 31, 2017 (1.3056 at July 31, 2016).The CDC's foreign exchange forward contracts as of the Statement of Financial Position date were as follows:

		January 31, 2017		July 31, 2016	
Currency sold	Currency purchased	In USD	In CAD	In USD	In CAD
USD	CAD	$ 0	$ 0	$ 694	$ 898
CAD	USD	$ 93	$ 22	$ 35	$ 45

These contracts will mature over the period ending February 2017. The maturity dates of the forward exchange contracts correspond to the estimated dates when the CDC expects to receive the foreign currency proceeds arising from export sales contracts or when payment for purchases in foreign currencies are due.

"Other charges (recoveries)" under operating expenses on the Statement of Operations and Comprehensive Income include $0.09 million representing net gains incurred during the current year (Q2 2015-2016: net losses of $0.33 million) arising from the determination of unrealized fair value remeasurements of the CDC's derivative financial instruments.

(In thousands of Canadian dollars, unless otherwise indicated)

The CDC's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

In CAD	January 31, 2017	July 31, 2016
Trade receivable	$ -	$ 13
Trade payable	(35)	-
Net derivative asset (liability)	2	(7)
Net exposure	$ (33)	$ 6

Based on the net exposure as of January 31, 2017, and assuming that all other variables remained constant, had the Canadian dollar appreciated 10% against the US dollar, net income for the quarter ended January 31, 2017 would have decreased by $0.16 million (Q2 2015-2016: increased by $0.09 million). Conversely, a 10% weakening in the Canadian dollar against the US dollar would have had the equal but opposite effect for the same period.

Interest rate risk

Interest rate risk is the risk that a financial asset containing a fixed interest rate component decreases in fair value with a rise in interest rates or that a financial liability with a floating interest rate component results in increased cash outflow requirements as a result of an increase in interest rates. Other than the line of credit, for which interest expense varies as a function of prime, and loans from the Government of Canada, which vary as a function of the yield on comparable Treasury bills, the CDC does not have any other such financial assets or liabilities exposed to this risk. The CDC's exposure to interest rate risk is not significant given its low interest bearing loans.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or currency risk. The CDC is not significantly exposed to this type of risk.

Liquidity risk

Liquidity risk is the risk that the CDC will not be able to meet its financial obligations as they fall due. As of the Statement of Financial Position date, virtually all of the CDC's assets and liabilities were current and the CDC had a current ratio equal to 1.62 (July 31, 2016: 1.27). In managing liquidity risk, the CDC has access to additional borrowings for commercial operations from the Government of Canada in the amount of $132.27 million as of January 31, 2017 (July 31, 2016: $70.81 million) as well as $6.40 million (July 31, 2016: $0.97 million) on its line of credit for the pooling of market returns.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the CDC. Maximum credit exposure is the carrying amount of the pooling and trade receivable balances, net of any allowance for losses. The CDC manages this risk using several strategies which include selling product on a “payment first” basis, securing of bank guarantees and obtaining letters of credit. As of January 31, 2017 and July 31, 2016 the CDC did not have an allowance for doubtful accounts and all trade receivables were current.

The CDC is exposed to credit risk when entering into foreign exchange contracts wherein the counterparty fails to perform an obligation as agreed upon, causing a financial loss. Maximum credit exposure is the notional amount of the derivative asset. The CDC manages this exposure to credit risk by entering into foreign exchange contracts only with major Canadian financial institutions. To date, no such counterparty has failed to meet its financial obligation to the CDC.

Fair values

The carrying value of cash, trade and other receivables, bank overdraft, and trade and other payables approximates their fair values due to the immediate or short-term maturity of these financial instruments. As of the Statement of Financial Position date, no amounts representing changes in fair value of these financial instruments have been recorded on the Statement of Operations and Comprehensive Income.

Fair value hierarchy

Financial instruments recorded at fair value on the Statement of Financial Position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy, which for the CDC is only relevant in the context of derivative financial instruments, has the following levels:

Level 1: valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3: valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value measurement of the CDC’s derivative financial instruments is classified as level 2 (July 31, 2016: level 2) in the fair value hierarchy. Changes in valuation methods may result in transfers into or out of levels 1, 2, and 3. For the reporting periods ended January 31, 2017 and July 31, 2016, there were no transfers between levels.

(In thousands of Canadian dollars, unless otherwise indicated)

12. Commitments

a) Industry Initiatives

Summary:	January 31, 2017
Dairy Research Cluster	$ 250
Matching Investment Fund	252
Total commitments for industry initiatives	$ 502

Dairy Research Cluster

The Dairy Farmers of Canada initiative enables key industry-led agricultural organizations to mobilize a critical mass of scientific and technical resources to support innovation strategies for enhanced profitability and competitiveness in their sector. The CDC has agreed to partially fund this project under an agreement that commenced April 1, 2014 and expires March 31, 2018. Under the terms of this agreement the CDC will contribute $0.75 million. A first payment of $0.25 million was made in 2014-2015, a second payment of $0.25 million was made in 2015-2016 and the balance of $0.25 million will be paid at the end of the agreement.

Matching Investment Fund

The CDC funds and administers the Matching Investment Fund which provides non-repayable contributions to Canadian-registered companies or food technology centres for product development, on a matching investment basis. As of January 31, 2017, CDC has outstanding commitments of $0.25 million.

b) Purchase Commitments

As of January 31, 2017, the CDC was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $3.64 million (July 31, 2016: $0.92 million) and will be fulfilled in February 2017.

c) WTO Tariff Rate Quotas for Butter

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product through butter manufacturers to the food sector. Insufficient supply of Canadian butter in the 2016-2017 dairy year required that the CDC import 12,000 tons of butter/cream in addition to its import butter TRQ of 3,274 tons. As of January 31, 2017, the remaining balance of butter/cream to import was 4,307 tons. World prices at the time of purchase determine the total financial commitment.

(In thousands of Canadian dollars, unless otherwise indicated)

The total cost to purchase imported butter for the quarter ended:

Three months		Six months	
Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
$ 42,063	$ 17,292	$ 77,154	$ 29,386

d) Operating Lease

The CDC is committed under a long term lease with Agriculture and Agri-Food Canada for office accommodation ending in March 31, 2017. The lease contains escalation clauses regarding maintenance costs and taxes. This lease may be automatically renewed at the CDC's option for another period of five years with rates possibly revised in order to reflect the rental market value pursuant to Treasury Board's Policy on Real Property.

The minimum lease payments are estimated as follows:

	January 31, 2017	July 31, 2016
Less than one year	$ 269	$ 117
Greater than one year and less than five years	$ 1,464	$ 234

13. Related party transactions

Government of Canada entities

The CDC, as per the *Canadian Dairy Commission Act*, is an agent of Her Majesty the Queen in right of Canada. This effectively gives the Government of Canada significant influence over the CDC and its activities.

The CDC is related in terms of common ownership to all other Government of Canada departments, agencies and Crown corporations. The CDC enters into transactions with these entities in the normal course of business and at normal trade terms. These related party transactions are recorded at their exchange amounts.

(In thousands of Canadian dollars, unless otherwise indicated)

In accordance with the disclosure exemption regarding "government related entities", the CDC is exempt from certain disclosure requirements of IAS 24 – *Related Party Disclosures,* relating to its transactions and outstanding balances with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Based on this exemption, the CDC has not disclosed any further details of its transactions with the Government of Canada and departments thereof, and all federal Crown corporations not considered to be individually or collectively significant, entered into in the normal course of operations.

Loans from the Government of Canada at terms available to Crown corporations (Note 6), which are recorded at the transaction price, represent the CDC's largest related party transaction.

Significant transactions, excluding loans, were with the following related parties:

Government entity	Three months		Six months	
	Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
Public Works and Government Services Canada	$ 256	$ 288	$ 531	$ 579
Agriculture and Agri-Food Canada (mainly operating lease – Note 12)	3	88	6	177
Other related Government entities	120	23	160	31
Total	$ 379	$ 399	$ 697	$ 787

Key management personnel

The CDC's key management personnel are the members of the Commission's Board and the directors.

No loans or other such transactions with key management personnel were outstanding as of January 31, 2017 or July 31, 2016, or occurred at any time during either year.

(In thousands of Canadian dollars, unless otherwise indicated)

The post-employment benefit liability for key management personnel as of January 31, 2017 was $0.08 million (July 31, 2016: $0.06 million) and is divided between "Post-employment benefits" and "Other liabilities" on the Statement of Financial Position.

Compensation of key management personnel for the quarter ended:

Three months		Six months	
Q2 2016-2017	Q2 2015-2016	Q2 2016-2017	Q2 2015-2016
$ 271	$ 240	$ 521	$ 459